

BOSTON EDISON COMPANY
CAMBRIDGE ELECTRIC LIGHT COMPANY
COMMONWEALTH ELECTRIC COMPANY
NSTAR GAS COMPANY

Direct Testimony of James J. Judge

Exhibit NSTAR-JJJ-1

D.T.E. 05-85

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1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is James J. Judge. My business address is 800 Boylston Street, Boston,
4 Massachusetts, 02199.

5 **Q. By whom are you employed, and in what capacity?**

6 A. I am Senior Vice President, Treasurer and Chief Financial Officer of NSTAR
7 Electric & Gas Corporation (“NSTAR”) and each of its four regulated distribution
8 companies, Boston Edison Company (“Boston Edison”), Cambridge Electric
9 Light Company (“Cambridge”), Commonwealth Electric Company
10 (“Commonwealth”) and NSTAR Gas Company (“NSTAR Gas”) (collectively, the
11 “Companies”).

12 **Q. Please describe your background and professional qualifications.**

13 A. I have served as the Senior Vice President and Chief Financial Operator of
14 NSTAR since its inception in 1999 following the mergers of BEC Energy (the
15 parent company of Boston Edison) and Commonwealth Energy Systems (the
16 parent company of Cambridge, Commonwealth and Commonwealth Gas
17 Company, which is the predecessor of NSTAR Gas). I served as Senior Vice
18 President and Treasurer of Boston Edison beginning in 1995. I also served in a

1 number of other positions within Boston Edison, including, Director of Corporate
2 Planning and Assistant Treasurer, Assistant Treasurer, Manager of Financial
3 Planning and Senior Financial Analyst. I joined Boston Edison in 1977 and I hold
4 Bachelor of Science and a Masters Degree in Business Administration from
5 Babson College.

6 **Q. Have you previously testified before the Department of Telecommunications**
7 **and Energy?**

8 A. Yes. I have testified in a number of proceedings before the Department of
9 Telecommunications and Energy (the "Department"). Most recently, I testified in
10 support of NSTAR's proposal to adopt a Pension Adjustment Mechanism for the
11 recovery of costs associated with pensions and post-retirement benefits other than
12 pensions, which was approved by the Department in D.T.E. 03-47 (2003). I also
13 testified in support of the petition for approval of a rate plan associated with the
14 merger of BEC Energy and Commonwealth Energy, which was approved by the
15 Department in D.T.E. 99-19 (1999).

16 **Q. What is the purpose of your testimony?**

17 A. The purpose of my testimony is: (1) to provide an overview of this filing; and
18 (2) to discuss the Companies' long-term business objectives and how those
19 objectives have shaped this filing. Each of these components is discussed in
20 detail below.

1 **II. OVERVIEW OF FILING**

2 **Q. Please describe the elements of this filing.**

3 A. This filing is a traditional, general rate case, for each of the Companies, based on
4 cost-of-service principles and filed in accordance with Department precedent.
5 Tariffs have been filed for each of the Companies with rates designed to
6 implement the requested rate increases.

7 **Q. Have the Companies proposed a performance-based ratemaking (“PBR”) in**
8 **consolidation with the traditional rate case?**

9 A. Not with this filing. The Companies are aware that the Department expects
10 companies to file a PBR proposal in the context of general rate cases. D.P.U. 94-
11 158 (1995), at 65-66. By agreement with the Attorney General, the Companies
12 will file a PBR proposal after the issuance of the Department’s order on the rate
13 case filings. This will essentially bifurcate the proceedings, but it is anticipated
14 that the PBR plan will be in place within a year of the date that new rates go into
15 effect. Thus, the PBR would take effect using those base rates and at the same
16 time as the PBR would have taken effect if it had been filed with the base rate
17 filings. That PBR plan would include both a price-cap index of the type
18 previously approved by the Department, as well as elements consistent with
19 NSTAR Electric’s plan to merge Boston Edison, Cambridge and Commonwealth
20 and to consolidate the rates for the three companies.

1 **Q. Please summarize the Companies' request for general rate increases.**

2 A. In traditional rate case filing, the Companies have filed tariffs that provide for a
3 total rate increases of approximately \$89 million, consisting of \$65.9 million for
4 Boston Edison, \$2.1 million for Cambridge, \$19.4 million for Commonwealth and
5 \$1.9 million for NSTAR Gas. As discussed below, these revenue deficiencies are
6 driven largely by the need for recovery of investment in the gas and electric
7 distribution systems. None of the Companies has filed for a base-rate increase for
8 over ten years.

9 **Q. What is the organization of the filing?**

10 A. The Companies are filing four costs of service, for Boston Edison,
11 Commonwealth, Cambridge and NSTAR Gas. NSTAR Electric will file a
12 petition for the merger of the electric companies a separate docket. The testimony
13 provided in support of the Companies' request for base-rate relief is as follows:

- 14 ▪ **Geoffrey Lubbock**, Vice President, Financial Strategic Planning & Policy
15 and **Christine Vaughan**, Manager of NSTAR's Revenue Requirements
16 Department in support of the cost-of-service calculations;
- 17 ▪ **Michael Farrell**, Assistant Controller and Director of Accounting for
18 NSTAR, supports the allocation of service company charges to the
19 NSTAR subsidiaries;
- 20 ▪ **Bernard Peloquin**, Director Total Compensation for NSTAR, supports
21 the justification of the level of employee compensation including benefits;
- 22 ▪ **Robert Martin**, Team Manager Investment Planning for NSTAR,
23 supports the capital investments added to rate base.
- 24 ▪ **John Spanos**, Vice President of Gannett Fleming, Inc. supports the
25 requested depreciation rates;

- **Paul Moul**, Managing Consultant, P. Moul & Associates supports the Companies' proposed return on equity;

III. NSTAR'S LONG-TERM BUSINESS OBJECTIVES

Q. What are the overall business objectives that are shaping this filing?

A. Put simply, NSTAR is at a critical juncture in terms of meeting customer needs and expectations for a safe and highly reliable energy supply. Since the merger of BEC Energy and Commonwealth Energy, NSTAR has been successful in achieving substantial gains in productivity, efficiency and the quality of service provided to customers. These gains, which have far surpassed the benefits outlined in the original merger rate plan approved by the Department in D.T.E. 99-19, have resulted from a broad-based effort to cut costs for customers through consolidation of operations, elimination of redundant facilities, implementation of systems and work processes and a multitude of other initiatives. While cutting expenses, the Companies have invested over \$1.2 billion in their electric and gas infrastructure between 2000 and 2004. They have doubled their rate of capital investment since the merger (see Exhibit NSTAR-JJJ-2). These investments have resulted in dramatic improvements in the quality and reliability of service provided to customers.

However, as NSTAR looks forward, there are substantial challenges ahead for the Companies and their customers. Customers are experiencing precipitous changes in prices for all types of energy, including electricity, home heating fuel and gasoline and the Companies recognize that many of their customers will bear

1 extreme hardships in the coming months in attempting to meet their energy needs.

2 At the same time, there are ever-increasing demands on the Companies to ensure
3 a level of electric and gas service that is highly evolved in terms of scale,
4 complexity, reliability and immediacy. As a regional transmission owner and the
5 electric distribution company serving the Greater Boston area, NSTAR Electric is
6 under intense pressure to serve customers in a social, economic and political
7 environment that is increasingly dependent on technology and increasingly
8 complex in terms of the sheer number of independent parties working in and
9 around NSTAR Electric's infrastructure. These factors are imposing service-level
10 requirements on the Companies that transcend historical levels and weigh heavily
11 on the Companies' resources and impose increased financial demands on the
12 Companies to provide ever increasing levels of service.

13 From an organizational perspective, NSTAR Electric has reached the point where
14 it needs to move forward to complete the final stages of its merger-related
15 consolidation activities in order to serve electric customers as a single (integrated)
16 electricity distributor. Currently, NSTAR Electric operates as a single, integrated
17 system from an operational perspective. However, NSTAR's three electric
18 companies exist as separate legal entities with customers of each company served
19 under differing rate structures and rate tariffs. To complete the consolidation of
20 operations made possible by the merger, NSTAR Electric needs to move forward

1 to integrate these corporate structures into a single unit with unified rate
2 structures.

3 Therefore, as the Companies look out over their long-term planning horizon, there
4 are three core business objectives that they seek to address over the next year.

5 These objectives are: (1) to set the stage to move forward with consolidation of
6 the three electric companies into a single legal entity with a unified rate structure;
7 (2) to obtain the revenues necessary to support the unprecedented levels of
8 investment needed to provide the level of service reliability sought by customers;
9 and (3) to establish a long-term performance-based ratemaking plan that will
10 afford customers a level of price stability while also providing the Companies
11 with a mechanism to avoid the need for subsequent base-rate cases over an
12 extended time period.

13 **Q. How does this filing address those business objectives?**

14 A. In the final analysis, the Companies have a fundamental obligation both to secure
15 the resources necessary to provide customers with safe and reliable distribution
16 service and to work to help their customers through this tumultuous period of
17 energy price volatility.

18 First, the Companies are submitting to the Department a request for base-rate
19 relief totaling approximately \$89 million. The Companies' substantial
20 infrastructure investments have had the inevitable impact of creating the need for
21 rate relief. This relief is vital to the Companies' continued ability to fund critical

1 infrastructure investments that drive system reliability. The Companies will file
2 shortly in a separate docket for approval of the consolidation of the electric
3 companies into a single legal entity that would operate on a fully integrated basis
4 as “NSTAR Electric Company.” This strategy includes a proposal to establish
5 uniform rate categories for the consolidated electric company and would set the
6 stage for future rate-design filings to set unified rate structures and rate tariffs.
7 Similarly, the Companies will file at the end of the general rate proceeding to
8 establish a long-term PBR plan that would provide a level of rate stability to the
9 Companies and its customers. In combination, these steps would provide the
10 Companies with the platform necessary to meet their service obligations over the
11 next decade.

12 **Q. Would you be more specific regarding NSTAR Electric’s objective of**
13 **completing the consolidation of the electric companies?**

14 **A.** With the merger of BEC Energy and Commonwealth Energy System and the
15 Department’s approval of the merger-related rate plan in D.T.E. 99-19, NSTAR
16 embarked on a multi-phase plan to achieve the complete consolidation of the
17 legacy utility systems. In this vision, utility operations would be fully integrated
18 over a number of years with customers of the unified system ultimately taking
19 service under common rate structures and rate tariffs. In the past six years, the
20 Companies have successfully implemented the initial stages of its consolidation
21 plan with substantial benefits inuring to the benefit of customers.

1 For example, as part of the merger-related rate plan approved by the Department,
2 distribution rates for the customers of the Companies were frozen for a period of
3 four years. This rate freeze followed a period of approximately eight years
4 wherein none of the legacy companies sought base rate relief from the
5 Department. As a result, the distribution rates of the Companies have been held
6 constant for about 13 years, which the Department has recognized represents a
7 rate decrease in real terms where inflation is occurring. During that same period,
8 the Consumer Price Index ("CPI") increased by more than 54 percent. Customers
9 have been the direct beneficiaries of these real-term price decreases.

10 The Companies have avoided distribution rate increases resulting from
11 inflationary increases and other cost pressures because of their ability to capture
12 cost savings through consolidation and integration of the utility operations
13 following the merger. In their merger-related rate plan filing with the
14 Department, the Companies presented a detailed savings analysis projecting total
15 savings of more than \$630 million in the ten years following the merger (2000-
16 09) (D.T.E. 99-19, at 73). In D.T.E. 04-2 (2004), the Department accepted
17 NSTAR's Merger Savings Report finding that it demonstrated savings of
18 approximately \$314 million in just the first three years following the merger (i.e.,
19 through 2002). This means that, rather than achieving the projected annual
20 savings of approximately \$63 million (on average), the Companies have achieved
21 average annual savings of more than \$100 million. Although these savings may

1 seem remote to customers who are now struggling with increasing energy costs,
2 these savings are real and substantial in terms of the distribution rates that would
3 otherwise have been in place.

4 Therefore, for the Companies, the merger has presented an unparalleled
5 opportunity to benefit customers through substantial and permanent reductions in
6 operating expenses. These reductions include administrative and general costs,
7 which have declined by 38 percent since the last base-rate proceedings of the
8 NSTAR Companies (see Exhibit NSTAR-JJJ-3) and direct distribution operations
9 and maintenance expense, which have increased by only 28 percent in the same
10 time period as compared to an increase in CPI of 54 percent (see Exhibit NSTAR-
11 JJJ-4). However, the Companies recognize that the full promise of the mergers
12 will not be realized until the electric companies are fully integrated, with
13 customers served under a unified rate structure and common tariffs. This final
14 step cannot be accomplished immediately and will require a multi-step process
15 involving phased rate-design changes. Accordingly, a central objective in this
16 filing is to set the stage to commence that process.

17 **Q. How is the issue of electric reliability factoring into the need for rate relief?**

18 A. The significance and emphasis on electric reliability in terms of both *transmission*
19 and *distribution* services cannot be understated. Unlike any time in NSTAR
20 Electric's history, customers and their public representatives are focused on
21 electric reliability and, as a result, are demanding a level of service that exceeds

1 historical levels. In Massachusetts, NSTAR Electric has taken the lead in making
2 the investment necessary to revitalize and develop the electric system that now
3 serves an economy that is based heavily on technology, medical services and
4 advanced research and development activities. Beginning in 2001, NSTAR
5 Electric senior management implemented a broad range of institutional changes
6 designed to re-establish the flexibility, reliability and responsiveness of the
7 electric distribution system. NSTAR Electric fundamentally changed its outlook,
8 its operating philosophy and its system-investment strategies, with the ultimate
9 goal of renewing its vital bond with customers. The Companies' core
10 management philosophy recognizes that the success of shareholders is
11 inextricably linked to the satisfaction of customers. Because the Companies'
12 ability to achieve customer satisfaction hinges directly on the safety and reliability
13 of distribution service, there is no higher commitment of the Companies'
14 management.

15 The end result of these and a multitude of other changes and innovations is
16 evident in the service-quality metrics on which the Companies reports on an
17 annual basis to the Department. In particular, NSTAR Electric's performance on
18 electric reliability metrics has improved dramatically above historical levels with
19 the duration of customer outages declining by 45 percent since 1995 and the
20 frequency of customer outages decreasing by 25 percent since 1995 (see Exhibit
21 NSTAR-JJJ-5). Still, despite these dramatic increases over historical service

1 levels, the Companies face a daily pressure throughout their service territory to
2 improve the reliability of system and to ensure against system failures that affect
3 our customers and the general public, regardless of whether those failures occur
4 as a result of forces external to the NSTAR system.

5 The service improvements achieved to date have resulted from the dedicated
6 efforts of the Companies' management and employees, as well as approximately
7 \$1.2 billion in electric infrastructure improvements between 2000 and 2004.
8 Annual investment levels are now about \$300 million, or double the annual
9 amount prior to the mergers of the BEC Energy and Commonwealth Energy
10 Systems in 1999. NSTAR Electric has added over 10 million feet of new wire
11 and cable, 22,000 new distribution transformers, over 16,000 poles, added and
12 enhanced distribution automation switches, and instituted more aggressive and
13 systematic tree trimming efforts. NSTAR Electric has substantially increased the
14 capacity of its distribution system through the construction of four new
15 substations, including a \$34 million investment in a new 115 kilovolt ("kV")
16 substation on Colburn Street in Boston, which will have a major impact on the
17 Companies' ability to upgrade the system in Roxbury, Jamaica Plain and
18 Dorchester. These neighborhoods are areas within the City of Boston that are
19 experiencing growth and renewal – and an ever-increasing need for electric
20 reliability. Since the merger, NSTAR Gas has added 2.1 million feet of plastic
21 mains and services, installed four new gate stations to supply new areas or

1 increase capacity in existing ones, added 21 new or rebuilt district regulators, and
2 81 miles of gas main relays. NSTAR Gas also installed 130 miles of new main to
3 supply natural gas to the 8,667 new services of our expanding customer base

4 Unfortunately, the Companies cannot maintain (or increase) these levels of
5 system investment without the ability to obtain revenues to support the revenue
6 requirement associated the underlying investment. Net of depreciation, NSTAR
7 Electric's \$1.2 billion investment in the distribution system represents an
8 incremental investment of approximately \$700 million. An annual revenue
9 requirement of \$127 million is required to support this incremental investment, all
10 else being equal. Thus, the Companies' infrastructure investment is the single
11 largest factor driving the need for base-rate relief at this point in time. In
12 addition, the Companies need revenues to fund these investments or they will
13 become more costly for the Companies (and their customers) to finance these
14 needed investments. Although the Companies have worked diligently to achieve
15 and retain their "A" level credit ratings for all operating companies, the return on
16 common equity for Boston Edison, Commonwealth and Cambridge has fallen
17 below the average return on equity for electric utilities. Credit rating agencies
18 have increasingly focused their ratings evaluations on overall business risk and an
19 adequate return on equity reduces the risk for the Companies' lenders. Reduced
20 risk, in turn, ensures that the Companies have access to capital at the lowest rates
21 available.

1 The need to deal with reliability and safety issues on an effective and sustainable
2 basis is a source of substantial business risk that needs to be recognized through
3 the ratemaking process because customers, ultimately, are the motivating force
4 and beneficiaries of the Companies' infrastructure efforts.

5 **Q. Does the NSTAR Electric's role as a transmission owner also factor into the**
6 **need for financial stability?**

7 A. Yes. As a regional transmission owner in a deregulated generation market,
8 NSTAR Electric is facing a heightened responsibility to contribute to the overall
9 reliability of the regional transmission system. When electric generation was
10 owned by local electric utilities, the utilities had the ability to access ample and
11 reliable power through the placement and construction of generating facilities. As
12 a result, there was less need for development of new, high-voltage transmission
13 thoroughways (although transmission reliability has always been a priority in the
14 New England region). The unbundling of electric service and the divestiture of
15 electric generation has placed choices regarding the development and placement
16 of electric generating facilities in the hands of the market. This factor, in
17 combination with load growth in the Greater Boston area and other portions of the
18 NSTAR Electric service territory, is putting pressure on NSTAR Electric to
19 undertake a number of transmission-related projects to ensure the continued
20 reliability of the overall system.

1 In particular, NSTAR Electric is in the process of constructing an 18-mile, 345
2 kV transmission line from Stoughton, Massachusetts to the K Street Substation in
3 South Boston in order to shore up regional transmission reliability in the Greater
4 Boston area. This project is the largest of its type undertaken by NSTAR Electric
5 in more than 20 years and will require a total investment of over \$200 million.
6 Although NSTAR Electric recovers its transmission costs through a ratemaking
7 mechanism that is separate from the Department's investigation of distribution
8 rates, NSTAR Electric must maintain the financial wherewithal and in-house
9 technical expertise to undertake (and successfully) complete projects of the scope
10 and magnitude in its function as a electric transmission and distribution owner. In
11 today's environment, there is business risk associated with this new role, which
12 will be reflected in the Companies' risk profile if we are unable to maintain a
13 strong financial position in all areas of our business.

14 **Q. What are other challenges that create business risk for the Companies?**

15 A. There are several other aspects of the Companies' day-to-day operations that have
16 the potential to create challenges for management and, to the extent that these
17 challenges are not adequately addressed, to create business risk. These challenges
18 include the need to reduce (where possible) the costs of energy supply to be borne
19 by customers, the need to achieve a high level of customer satisfaction through
20 improved interactions with customers and services that assist customers in
21 managing their own energy needs and the need to attract, maintain and motivate

1 employees. To deal squarely with these challenges, the Companies have initiated
2 significant initiatives on all of these fronts that are producing benefits for
3 customers.

4 **Q. What efforts have the Companies undertaken to control energy costs?**

5 A. As a result of divestiture, the Companies do not own electric generating plants
6 and do not engage in energy marketing. However, most customers continue to
7 rely on the Companies to supply them with energy as well as delivery services.
8 Although the Companies provide this energy to customers at cost and do not earn
9 any profits on these sales, the Companies strongly believe that part of their
10 customer-service mission is to work to provide this energy supply at as low a cost
11 to customers as reasonably possible. Because the market rules that govern
12 wholesale energy markets in New England have an enormous impact on the cost
13 of energy to our customers, the Companies have willingly and energetically
14 adopted an active role as “customer advocate” in the complex arena of wholesale
15 market structuring. We estimate that the Companies’ efforts have saved our
16 customers over \$1 billion in energy costs.

17 For example, a key issue affecting our customers has been the proposed adoption
18 by ISO-NE of a concept referred to as Locational Installed Capacity (“LICAP”),
19 which would cause customers in New England to pay to generators over \$13
20 billion over just the next five years. NSTAR Electric believes this structure is
21 poorly designed and that a significant portion of this payment is unnecessary.

1 Therefore, NSTAR Electric performed an extensive analytical evaluation of the
2 structure and economic impacts of LICAP and played a key role in forming a
3 broad coalition to oppose the ISO-NE LICAP market rule at the Federal Energy
4 Regulatory Commission (“FERC”). In parallel, NSTAR Electric played a key
5 role in developing regional political awareness of the high stakes associated with
6 this proposal for electric customers throughout Massachusetts. This concerted
7 effort resulted in the majority of the New England congressional delegation, along
8 with the governors, Attorney Generals and commissioners of all six New England
9 states, sending a letter to FERC urging it to reject LICAP. In response, FERC
10 postponed the implementation of LICAP to October 2006, with a likely
11 implementation date no sooner than January 2007. This initial one-year delay
12 alone will save New England customers close to \$1.3 billion, with savings to
13 Massachusetts customers of \$670 million. NSTAR Electric’s ongoing efforts,
14 along with other members of the coalition, are likely to result in a less expansive
15 LICAP outcome in the final analysis, which over the next five years is expected to
16 save our customers up to 25 percent on their energy costs.

17 NSTAR Electric has also been active on other market design issues, including
18 Daily Reliability Must Run (“RMR”) charges, payments for low-voltage support,
19 the creation of long-term RMR contracts and the design and implementation of a
20 Locational Forward Reserve Market. Over the past two years, we estimate that
21 our engagement on behalf of customers on these energy market issues has saved

1 customers approximately \$850 million, with the potential for recurring, annual
2 savings of nearly \$200 million.

3 **Q. What other steps has NSTAR Electric undertaken to reduce energy costs for**
4 **customers?**

5 A. A major initiative that NSTAR Electric has undertaken is the reduction of costs
6 associated with historical contracts to purchase energy from non-utility
7 generators. In 2004 and early 2005, NSTAR Electric bought out or bought down
8 contracts with five non-utility generating interests and securitized the payments to
9 the extent possible. This restructuring saved customers of NSTAR Electric
10 approximately \$200 million.

11 **Q. What steps have the Companies taken to improve customer satisfaction apart**
12 **from electric-reliability investments?**

13 A. The Companies have made significant strides in revitalizing and strengthening
14 their vital bond with customers. In today's rapidly changing energy environment,
15 the need to develop partnerships with customers has never been greater. To that
16 end, the Companies conduct award-winning energy-management programs for the
17 benefit of customers. The Companies also have established a personalized
18 account executive network to serve customers in combination with the "Tech
19 Center," which is communications network for Commercial and Industrial
20 ("C&I") customers. The Companies' Vice President of Customer Care makes
21 personal visits to commercial customers. These visits provide an excellent forum
22 to hear the customers' concerns and desires as well as to discuss energy services

1 and future business plans. The Companies' "Voice of the Customer" board is a
2 cross functional team that has the responsibility of reviewing all forms of
3 customer feedback, identifying trends and developing action items to improve
4 service and response. Lastly, in response to customer feedback, the Companies
5 have continued to meet and exceed service-quality goals around meter reading
6 and telephone response.

7 **Q. What are the "award-winning" energy managements programs conducted by**
8 **the Companies to assist customers with their energy needs?**

9 A. For over a decade, the Companies have been implementing energy efficiency
10 programs that are designed to serve the needs of their residential, low-income, and
11 C&I customers. The Companies provide high-quality programs and services to
12 their customers to promote energy efficiency, assist in transforming energy
13 efficiency markets and help customers achieve permanent energy savings. In
14 doing so, the Companies build upon established marketplace relationships, refine
15 the focus of their programs to meet market-oriented objectives, and, whenever
16 possible, coordinate their activities with other regional utilities and market
17 players. In implementing and administering these programs and services, the
18 Companies' overall goal is to help customers understand their energy
19 consumption and to use energy more efficiently. In 2003, NSTAR Electric spent
20 approximately \$41 million on electric energy efficiency programs, which
21 increased by over 29 percent to \$53 million in 2004. In 2004, NSTAR Electric's
22 energy efficiency programs provided direct services to over 15,900 customers in

1 the residential, low-income, and C&I market sectors. In addition to providing
2 direct services, NSTAR Electric's programs also provided lighting and appliance
3 products and rebates to 35,248 NSTAR Electric customers. Overall, in 2004,
4 NSTAR Electric's energy efficiency programs saved a total of 2.3 lifetime
5 terawatt-hours ("tWh"), 420 lifetime megawatts ("MW") and \$21.5 million in
6 lifetime non-electric benefits.

7 **Q. What is NSTAR's commitment to the environment?**

8 A. Concern for the environment is part of NSTAR's corporate mission statement and
9 is reflected in the environmental policy adopted by the Companies. Active,
10 Temporary Solutions and MGP sites (i.e. all state-listed sites) went from 43
11 (1997) to 6 (2005 Q3), or an 86 percent reduction (Exhibit NSTAR-JJJ-6).
12 Additionally, NSTAR cleaned up three sites that had activity-use limitations,
13 reducing these from nine to six. Besides the Companies' formal demand-side
14 management programs, other examples of NSTAR's commitment to the
15 environment include voluntary programs such as removing PCB-equipment and
16 eliminating gasoline and diesel underground storage tanks. Wetland and species
17 issues are considered along the miles of the Companies' right of ways. NSTAR
18 continues to work closely with local Conservation Commissions, the
19 Massachusetts Association of Conservation Commissions, and National Heritage
20 to ensure minimum impact while maximizing public safety and system reliability.
21 NSTAR's right-of-way vegetation management program is evolving, combining

1 numerous approaches for selective maintenance to encourage low-growing trees
2 while improving bio-diversity within these areas. As the NSTAR system is
3 updated and expanded, many of these projects are providing support for local
4 environmental enhancements such as storm water management, tree plantings,
5 and soil management.

6 **Q. What steps have the Companies taken to attract, maintain and motivate**
7 **valuable employees?**

8 A. The Companies have made a commitment to be a premier employer in the region.
9 To that end, the Companies promote open internal communications. Officers
10 meet regularly with small groups of employees to discuss challenges and
11 direction. The Companies are also working hard to promote more effective
12 communication and to involve more employees in planning processes. The
13 Companies strive to maintain the balance of competitive pay and benefits in order
14 to attract highly qualified and motivated employees, while balancing the cost to
15 customers. The Companies invest in employee health and wellbeing through
16 wellness programs. An integrated Human Resources Planning process has been
17 established with the mission of acquiring, developing and retaining diverse talent
18 to build a leadership pipeline, ensure continuity in critical impact positions, and
19 diversify the business while at the same time aimed at improving productivity,
20 encouraging creativity and rewarding the rising performance of our employees.

1 The Companies' leadership "bench strength" is assessed annually through the
2 Talent and Succession Management processes. To increase organizational
3 performance and effectiveness, a systematic process has been implemented to
4 ensure continuity in key positions, identify and develop high-potential employees,
5 to develop and retain key talent for the future and encourage individual
6 advancement. An integrated First-Line Leadership, developed to engage front-
7 line management employees, is designed to expand the supervisors' knowledge of
8 the business, to build skills to improve their performance and to foster
9 relationships with the senior leadership team. Other employee development and
10 retention initiatives include an on-site Power Systems Management Graduate
11 Certificate Program (in partnership with Worcester Polytechnic Institute) in
12 addition to the corporate undergraduate and graduate tuition reimbursement
13 programs.

14 The Companies conduct an annual Employee Survey, which is administered to all
15 employees. Once results are compiled, strategies are developed and implemented
16 to address continuation of successes and areas of opportunities. Individuals and
17 teams throughout NSTAR whose extraordinary contributions and achievements
18 further the Companies' mission are eligible for an Employee Recognition Award.

19 Lastly, the Companies have formed a number of educational partnerships to equip
20 the current and future work force with the skills and capabilities necessary to
21 ensure continuity and improvement of the business. Working with Bunker Hill

1 Community College and Local 369 UWUA, the Companies have developed an
2 Electric Power Utility Technology Program, which provides students an
3 opportunity to achieve a two-year Accredited Associate of Applied Science
4 Degree preparing them for employment in a variety of electric fields. Our
5 Supervisor Trainee Program, a 12-month development initiative for Engineering
6 students recently hired into our Operations organization, has been designed to
7 provide new supervisors with the tools and skills to effectively lead people to
8 serve our customers well.

9 **Q. Why is it important that the Companies have a strong financial condition?**

10 A. A strong financial condition is necessary for the Companies to continue to meet
11 its obligations to serve customers, employees and shareholders. A strong
12 financial condition is also necessary for the Companies to respond to
13 unanticipated events; such as precipitous cost increases and economic downturns.
14 Conservative financial practices, a solid balance sheet and overall strong credit
15 quality are all hedges against the myriad of ever increasing risk factors facing the
16 Companies.

17 Investors perceive additional risk facing the industry from several sources;
18 including but not limited to:

- 19 1. The passage of the National Energy Policy Act and formation of Regional
20 Transmission Organizations highlight the increased emphasis being placed

1 on reliability and the significant capital investments needed to upgrade and
2 maintain the transmission system;

3 2. Technological advances in microturbines and commercial fuel cells
4 combined with the utility's obligation to serve may result in rate base
5 investments that potentially become stranded;

6 3. Increasing regulatory scrutiny of service quality levels that now hold
7 companies responsible financially for meeting tougher and tougher
8 operational standards;

9 4. The unpredictable nature of wholesale energy markets and increased
10 customer volatility due to customer switching and weak economic
11 conditions possibly resulting in erosion of revenues; and

12 5. Significant investments in non-core, unregulated business activities.

13 The convergence of unmitigated risks and weak financial condition resulted in a
14 severe and rapid credit collapse in the utility industry in the 2001-2003 time
15 period. During this period there were 619 credit ratings downgrades as compared
16 to 137 credit upgrades issued by Moody's, Standard & Poor's and Fitch ratings
17 services, a 4.5:1 ratio. In addition, an unprecedented number of utilities filed for
18 bankruptcy protection, including Pacific Gas & Electric, NRG, Mirant and
19 NorthWestern Corp. In an effort to reduce risk and strengthen credit quality
20 across the industry, U.S. investor-owned electric utilities have issued more than

1 \$20 billion in common equity over the last two years. Today, the utility industry
2 average credit rating is in the “mid-BBB” range as compared to the A/A- range
3 just a few years ago.

4 A strong financial condition and correspondingly strong credit quality are
5 necessary to provide the Companies with the highest degree of financial
6 flexibility in order to attract capital on reasonable terms no matter what the
7 economic conditions are. A financially strong NSTAR can serve its customers by
8 lowering borrowing costs and permitting it to continue to obtain capital at lower
9 rates through all economic cycles, and where appropriate to expand its high level
10 of service and reliability. A financially strong NSTAR is able to attract and retain
11 the best employees whose creativity and performance will lead to greater
12 customer and shareholder satisfaction. A financially strong NSTAR serves its
13 shareholders by offering a reasonable return on investment which in turn
14 encourages investment in the NSTAR and thereby increases its financial integrity.

15 No utility, or any business for that matter, likes to raise its prices, especially in the
16 economic circumstances in which we find ourselves today. However, for the
17 Companies to continue to meet their public service obligations in the manner
18 which our customers expect and deserve, this rate increase is necessary. NSTAR
19 Electric and NSTAR Gas have proven their ability to manage these difficult times
20 and are positioned to lead the evolving utility industry. Financial strength is the
21 cornerstone to continuing these efforts.

1 **Q. Please describe the Companies' current financial performance.**

2 A. The Companies' recent financial performance is mixed, but overall relatively
3 stable. The Companies net income growth, dividend growth, total shareholder
4 return and return on equity have all generally been near or below the industry
5 average in 2003 and 2004.

6 The return on common equity ("ROE") for Boston Edison, Commonwealth and
7 Cambridge has been below the average electric utility return on equity. The
8 return on common equity for NSTAR Gas slightly exceeded the average ROE for
9 gas utilities in 2004 and was slightly below average in 2003.

10 On the positive side, the Companies' financial condition is strong. NSTAR has
11 worked diligently to increase and retain its "A" level credit ratings for all
12 operating companies as well as the parent. The rating agencies typically identify
13 three common reasons for their rating rationale for the Companies.

14 1. Management's conservative business approach that is focused on
15 regulated electric and gas distribution networks.

16 2. A constructive regulatory environment providing recovery of transition
17 costs, energy supply and pension related costs on a timely basis.

18 3. Adequate cash flows and liquidity to meet debt maturities and capital
19 spending needs.

1 The Companies' credit ratings have improved over recent years, bucking a
2 downward credit slide that began in 2000 for the U.S. investor-owned utility
3 industry. The average Standard & Poor's rating for the power sector as a whole
4 is in the mid-BBB area.

5 **Q. Why is the rate of return on common equity important to an electric utility?**

6 A. The Department has a statutory responsibility to balance the interests of a utility
7 company's customers and its shareholders. In order to make the investments
8 necessary to meet the needs of our customers, the Companies must attract
9 investment dollars. To successfully attract these dollars, investors must expect a
10 fair, competitive return. Debt investors want adequate interest coverage which
11 higher returns on equity will help to provide. Since the merger in 1999, the
12 Companies' returns on common equity have generally fallen below the average
13 electric utility's ROE. Even while agreeing, as part of a settlement, to freeze base
14 distribution rates, the Companies believe they have done a superior job in meeting
15 the needs of their customers. The Companies have :

- 16 • Saved customers significant amounts by restructuring, buying out of
17 and securitizing above market purchased power NUG contracts.
- 18 • Played a very significant role in containing power market abuses in
19 New England that could save customers hundreds of millions of
20 dollars.
- 21 • Invested millions in capital improvements to deliver safe and reliable

1 energy to customers. The Companies have nearly doubled capital
2 investment since the merger while the electric utility industry overall
3 has experienced a 12 percent decline in capital investments since
4 2000.

5 In light of this performance and the commitment of capital, the Companies
6 are entitled to an allowed rate of return at the upper end of the reasonable range
7 to reflect our exceptional performance and as an incentive for further
8 improvements.

9 **Q. Does this conclude your testimony?**

10 **A. Yes.**